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C O N F I D E N T I A L SECTION 01 OF 03 BAGHDAD 002115

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SUBJECT: SHAHRISTANI PUSHING FOR REFORM IN THE MINISTRY OF
OIL

REF: BAGHDAD 1552

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Classified By: Economic Minister Counselor Tom Delare, for reasons 1.4
(b) and (d).

11. (C) Summary: In a positive meeting June 16 with Econ staff members, Minister of Oil Husayn al-Shahristani focused on four areas of reform for his Ministry: hydrocarbon legislation, liberalization of fuel imports, improved contracting procedures, and rooting out corruption. His goals, especially for oil production and increased domestic supply of refined products, are very ambitious, and he is eager to engage with the USG on security and anti-corruption issues. End Summary

HYDROCARBON LAW

12. (C) Shahristani realizes that Iraq will not get serious foreign investment until hydrocarbon legislation is passed that serves to protect private investment. He feels that the legislation should ensure that revenues go to the National Treasury to support the national budget as approved by Parliament. While exploration and production will remain under state control, the downstream--refining, import and sale of products, and distribution--should be privatized.

13. (C) When asked about how the Ministry of Oil (MoO) will handle the proliferation of draft legislation that is being provided by private oil companies, international organizations, and previous government officials, Shahristani replied that he actually welcomes additional versions of hydrocarbon laws. He referred to a team within the Ministry established to review all of the proposals to determine approaches that best fit Iraq. (Note: A USG-contracted legal advisor has already been working with this committee, marking an improvement over the previous administration which regarded U.S. input as intrusive. End Note.). He acknowledged that dialogue with different regions-especially Kurdistan--will be necessary for successful legislation. He has also advised Parliament that all new contracts be issued through public tender, with both tenders and executed contracts being made available to the public via the Internet.

IMPORT LIBERALIZATION

14. (C) Minister Shahristani announced that he was, that

afternoon, presenting draft fuel import liberalization legislation for discussion and ultimate approval by the Council of Ministers and Parliament. He seemed confident that the legislation would be accepted without a problem because he had already discussed it within the Cabinet-concluding, therefore, that introducing market liberalization by Council decree would be unnecessary. He stated that the law should be passed within a few months, though he didn't expect that a significant amount of imported product will be available to the domestic market through private importers until the end of the year. Shahrastani elaborated that import licenses would be granted by the Ministry through the State Oil Marketing Organization (SOMO), currently the only entity permitted to import petroleum products. Potential importers would need to prove they possess adequate capital and means of transportation, as well as the ability to meet environmental and safety requirements. There would be no pricing regulations, so importers would compete in an open market.

REFINING CAPACITY

15. (C) The Minister expressed his goal of increasing production of refined product to a total of 1.05 million barrels per day (bpd) to meet domestic needs-a figure that includes expected demand growth. He described a medium-term refinery construction plan that should help the Government of Iraq (GOI) meet that goal within three to four years. This refinery plan will ensure that each of the five main regions in Iraq will have a refinery to provide for local needs-a strategy that we believe is not as economically sound as it is politically savvy. Existing refineries, such as that at Daura, will receive new units as older ones are decommissioned. Ten small plants will also be decommissioned as new facilities in areas such as the Central Euphrates and Nasiriyah are built. Shahrastani explained that these capital investments are covered in the MoO's current budget. Of note

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is the new Kouya refinery to be built near Sulaymaniyah to take oil from new fields being developed in Kurdish territories. (Comment: The Minister has engaged in discussions with the Kurds on the Kouya project, demonstrating cooperation between the central and regional governments in development of hydrocarbon resources. End Comment)

PRODUCTION AND FUEL PRICES

16. (C) Shahrastani pointed to a 20 thousand bpd increase in oil production since he became Minister, stating that exports the day before (June 15) had been 1.5 million bpd. He commented that all of that increase was due to pumping through the export pipeline to Ceyhan, and recognized the need to protect the pipeline. He has already engaged with the Ministry of Defense and Multi-National Forces-Iraq (MNF-I) to improve infrastructure security from Bayji to Kirkuk.

17. (C) Despite lower than projected production during the early part of 2006, Shahrastani is confident that current production levels will ensure that Iraq meets-even slightly exceeds-IMF Standby Agreement (SBA) expectations. He also confirmed that the GOI would implement SBA-required fuel price hikes for both March and June by June 30. He even said the planned price hikes would be higher than stipulated by the IMF. (Note: Price increases were actually implemented on June 19 for diesel, kerosene and LPG, with new fuel prices reported at: LPG: ID 1000 per 12 Kg cylinder; Diesel: ID 125 per liter; Kerosene: ID 75 per liter; Gasoline: ID 175 per liter for 80 octane, ID 250 per liter for 86-87 octane, and ID 350 per liter for 91 octane; and Residual Heavy Fuel Oil: ID 200,000 per metric ton. At a subsequent meeting on June

20, the Minister stated gasoline prices had not yet increased, but would sometime before the end of the month. New subsidy reform public service announcements were not ready to air prior to these increases. End Note)

18. (C) The Minister articulated a goal of increasing oil production to 4.3 million bpd by the end of his term in 2010, insisting that the figure was possible through exploitation of existing fields and facilities and with minimal help from outside partners. He expects production of 6.7 million bpd by 2012, for which, he admits, new fields will need to be developed. In order to explore and produce these fields, Shahrستاني acknowledged that hydrocarbon legislation and participation of international oil companies will be necessary. (Comment: Shahrستاني's goals are extremely optimistic, as many observers believe that considerable new development, infrastructure, and equipment will be necessary to meet even the stated 2010 target. With new fields taking 4-5 years to develop, barring new fields coming online, IRMO estimates that 750 thousand additional bpd is a more realistic figure for increased production for a total of 3.15 mbpd vice 4.3 mbpd by 2010. End Comment).

SHAHRISTANI PUSHING FOR IMPROVED CONTRACTING PROCEDURES

19. (C) The Minister admitted "everyone knows there has been a lot of corruption in the Ministry of Oil." Recently, the Minister cancelled about 20 fuel purchase contracts due to suspected corruption, including contracts for importing fuel from Kuwait because he was suspicious they "weren't clean." Shahrستاني said he plans to push at the Cabinet level for sending corruption cases to court. He also said he will remove people involved in corrupt contracting.

110. (C) Shahrستاني expressed his displeasure with American contractors KBR and Parsons, and their inability to complete the projects for which they have been retained. He gave one example of a Parsons contract to meter loading at the ABOT export terminal, which has been languishing for two years. He said KBR and Parsons keep making excuses for why work is not finished, and despite their appreciation for USG funding of these projects, the Iraqis would have preferred finding alternate means of financing had they known how little oversight would be exercised over these projects. Shahrستاني made this same point to the Ambassador in his initial meeting as Minister with Emboffs on May 28 (reftel Baghdad 1552). When asked how the USG could mitigate the situation, he said we should hold our contractors accountable for performance delays since we are paying them. To emphasize his point, the Minister said he has fired employees in his Ministry due to corruption or inability to meet performance schedules.

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ROOTING OUT CORRUPTION IN THE MoO

111. (C) Sharihtani recounted to us his June 15 introductory conversation with Secretary of Energy Samuel Bodman, in which he told the Secretary that he needs help rooting out corruption in his Ministry. Shahrستاني said he plans to meet with his senior MoO staff to compile a list of priorities for discussion when the Secretary visits Iraq. We will follow up with the Minister to gather these points before Secretary Bodman's visit.

112. (C) Econ Counselor informed Shahrستاني that the Embassy has an interagency Anti-Corruption Working Group (ACWG) that can help the Minister identify corruption at the MoO. He offered for the group to work with his Inspector General (IG), Dr. Ali Alaq, on identifying specific cases of corruption in the Ministry. Shahrستاني said he has a close

working relationship with his IG, who briefs him every morning. The Minister stated that he told his IG's staff that they are independent, and free to interview any employees and request any material they deem necessary to investigate cases. He has also empowered them to perform spot inspections in the field (distribution depots, retail outlets, etc). He also told them that if anyone refuses the IGs access, the IGs should report back to the Minister. Additionally, the IG prepares a daily report on how much oil has been loaded that day in addition to the two operational reports from SOMO and the South Oil Company.

COMMENT

¶13. Shahrستاني seemed confident in his new role, detailing actions he is pursuing in priority areas such as fuel import liberalization and fuel price increases, as well as improving oil production and refining. He also seemed serious about addressing corruption within the Ministry of Oil, though he appeared more focused on specific intelligence on corrupt Ministry personnel rather than the impact of sectoral reforms that would undermine financial incentives leading to corruption. Though he is supportive of fuel price and import reform, his appreciation for the importance of such measures seems more financially motivated (to meet IMF requirements or increase revenues). Shahrستاني was not nearly as specific in a way forward on passing hydrocarbon legislation as he was with achieving production and refining improvements. He glossed over of how the Ministry's internal committee will reconcile the multitude of model and draft laws is cause for some concern. The Minister was overly optimistic in his projections for increased oil production by the end of his term in office, casting some doubt on other declarations, such as his expectations for increased transparency within his Ministry. More generally, the tone of the meeting was encouraging considering initial misgivings about Shahrستاني's level of receptivity to U.S. involvement. He was timely, professional, and responsive--conducting the meeting like a Chief Executive Officer aware of the challenges facing his organization, but prepared with a strategy for addressing these challenges. He downplayed dependence on U.S. resources, asserting the ability of the Ministry to undertake proposed initiatives--except in the area of security.

SPECKHARD